

Audit

Report



OFFICE OF THE INSPECTOR GENERAL

ALLEGATIONS INVOLVING AN AIR FORCE
CONTRACT FOR THE SPECIAL SENSOR
MICROWAVE IMAGER/SOUNDER

Report No. 96-017

October 27, 1995

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Acronyms

CAT
DMSP
SMC
SSMIS

Claims Analysis Team
Defense Meteorological Satellite Program
Space and Missile Systems Center
Special Sensor Microwave Imager/Sounder



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MEMORANDUM FOR ASSISTANT SECRETARY OF THE AIR FORCE
(FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Audit of Allegations Involving an Air Force Contract for the Special Sensor Microwave Imager/Sounder (Project No. 5CH-8014)

Introduction

We are providing this report for your information and use. We performed the audit in response to allegations made to the Defense Hotline. Those allegations charged that:

- o an Air Force official exerted undue influence over the disposition of an equitable adjustment claim filed by Aerojet-General Corporation (Aerojet) on contract F04701-89-C-0036 for the Special Sensor Microwave Imager/Sounder (SSMIS) and

- o two special Air Force reviews directed by the Air Force official of the SSMIS acquisition program and the equitable adjustment claim filed by Aerojet were not independently or fairly conducted.

The Air Force Space and Missile Systems Center (SMC) awarded contract F04701-89-C-0036 to Aerojet for the development and production of five SSMIS units for the Defense Meteorological Satellite Program (DMSP).

Audit Results

The audit did not substantiate any of the allegations. The Air Force official acted within the official scope of authority regarding the Aerojet claim on contract F04701-89-C-0036. Both reviews directed by the Air Force official were fairly conducted, although they were not conducted independently of the Air Force. The management control program was effective in that no material management control weaknesses were identified.

Audit Objectives

The overall audit objective was to determine whether the Air Force complied with applicable statutes and acquisition regulations for the procurement, administration, and program management of the DMSP. The specific objectives of the audit were to determine the merits of the allegations made to the Defense Hotline and to evaluate the adequacy of applicable management controls.

Scope and Methodology

Interviews and Documentation Review. We interviewed personnel and reviewed available documentation at the Office of the Assistant Secretary of the Air Force (Acquisition), the Air Force Materiel Command, SMC, and the Defense Contract Management Command. We also reviewed documentation and correspondence relating to contract F04701-89-C-0036 and the Air Force analyses of the SSMIS program and the Aerojet equitable adjustment claim.

Audit Period, Standards, and Locations. This program audit was performed from May through August 1995 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Office of the Inspector General, DoD. Accordingly, we included such tests of management controls as were considered necessary. We did not rely on any computer-processed data or statistical sampling procedures to perform the audit. Enclosure 1 lists the organizations visited or contacted during the audit.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of the Management Control Program. We reviewed the adequacy of management controls related to the critical program management elements in the DMSP program. We did not assess the adequacy of management's self-evaluation of those controls.

Adequacy of Management Controls. Management controls applicable to the DMSP program were deemed to be adequate in that we identified no material management control weaknesses.

Prior Audits and Other Reviews

We did not identify any previous audits of the Air Force management of the SSMIS acquisition. The Air Force performed two special reviews of the SSMIS acquisition that are discussed in this report.

Audit Background

The DMSP Program. The DMSP program began 30 years ago and has included several production buys of satellites to provide state-of-the-art tactical weather forecasts in support of a broad range of military missions. The current production buy is for five Block 5D-3 satellites. The Air Force has seven associate contractors responsible for components of the DMSP Block 5D-3 satellites. Aerojet is the associate contractor for development and production of the SSMIS. The DMSP program is managed by the DMSP systems program office at SMC.

SSMIS Research, Development, and Production. Contract F04701-89-C-0036 is a combined research, development, and production effort. On March 13, 1989, the Air Force competitively awarded the contract for development and production of the SSMIS. The SSMIS replaces three sensors used on previous satellites and has enhanced capabilities. The Air Force plans to install the SSMIS on Block 5D-3 satellites as Government-furnished equipment. The contract included a research and development portion funded through a cost-plus-award-fee arrangement for \$35.6 million, as well as production of the five SSMIS units funded on a fixed-price-incentive-fee arrangement with a ceiling price of \$72.7 million. Successful completion of the critical design review in September 1991 ended the research and development phase of the SSMIS acquisition.

Status of SSMIS Production. Aerojet should have delivered the first SSMIS unit on August 31, 1993. However, because Aerojet encountered cost and schedule problems during the production phase, the first SSMIS unit has not been delivered as of the date of this report. The SMC Commander reported to Air Force officials that Aerojet estimated the first SSMIS delivery will occur between November 29, 1995, and June 30, 1996. The Air Force issued potential termination for default cure notices to Aerojet in October 1990, November 1993, and April 1995 for failure to meet delivery schedules.

Aerojet Claim. In August 1994, Aerojet filed a certified equitable adjustment claim on the SSMIS contract for \$40.8 million with the Armed Services Board of Contract Appeals. The claim alleges that:

- o the Government forced Aerojet to perform research and development work during the fixed-price production phase of the SSMIS contract,
- o Government threats forced Aerojet into SSMIS production prematurely, and
- o Aerojet and the Government were parties to a mutual mistake because SSMIS work efforts were more complex than either party had anticipated.

The Aerojet equitable adjustment claim covers costs through February 1994. Aerojet considers as potentially claimable the development work performed until the first SSMIS delivery. In addition, Aerojet has filed counter claims on Government demands for a \$6.7 million repayment of progress payments and for liquidated damages of \$1.7 million.

Discussion of Allegations and Audit Results

The following is a discussion of each allegation made to the Defense Hotline and the audit results for each allegation.

Allegation 1. Senior Air Force officials met on several occasions with Aerojet executives during 1994 and 1995 while the Aerojet equitable adjustment claim on SSMIS contract F04701-89-C-0036 was pending before the Armed Services Board of Contract Appeals.

Audit Results. Aerojet executives and Air Force officials did meet during 1994 and 1995 to discuss the problems of the SSMIS contract. Memorandums on the meetings state that Aerojet executives attempted to persuade DoD and Air Force officials that the Government made program management and funding errors that affected SSMIS contract delivery and that Aerojet was entitled to an equitable adjustment under the contract terms. The purpose of the meetings was to notify senior DoD officials of the submission and basis of the claim and to preserve friendly customer relations.

Allegation 2. As a result of meetings with Aerojet executives, an Air Force official directed the formation of an Air Force "Red Team" to review the Air Force administration of the SSMIS contract. The team also was to explore avenues of claim settlement because the Air Force official had rejected seeking extraordinary relief for Aerojet under Public Law 85-804, "National Defense-Contracts," August 28, 1958.

Audit Results. In June 1994, the Air Force official directed the formation of an independent SSMIS review team called the Red Team. The Air Force official tasked the Red Team to review Aerojet assertions that SMC forced Aerojet to prematurely report completion of the full-scale development phase of the SSMIS. The Red Team reported its conclusions and recommendations to the Air Force official on August 31, 1994. The Red Team concluded that the Air Force might share responsibility for SSMIS design and production problems. The Red Team recommended that the DMSP systems program office obtain additional documentation from Aerojet to support the claim and that the program office budget additional research and development funding for the SSMIS. No documentation existed that the Red Team was formed because the Air Force official had rejected Public Law 85-804 extraordinary relief for Aerojet.

Allegation 3. The Air Force official who directed the formation of the Red Team refused to consider the legal position of the Air Force attorneys responsible for litigating the case.

Audit Results. Correspondence and other documentation indicate that the Air Force official was aware of the legal position of the Air Force litigation attorneys. The Air Force official's actions were proper because appraisal of the claims and development of a settlement strategy is to the Government's advantage. If the contractor's claims have merit, the advantage of a settlement

is that the Government will know what it is getting and will save interest expense. Litigation results in uncertainty, delay, and a greater investment in resources for litigation support.

Allegation 4. After completion of the Red Team review, the Air Force official ordered SMC to form a claims analysis team (CAT) to perform an independent technical and price analysis of the Aerojet claim. The CAT chairman:

- o was biased and understood that the Air Force official wished to settle the Aerojet claim,

- o recommended that the SMC SSMIS contracting officer be removed for opposing settlement of the claim, and

- o believed that an additional \$100 million might be needed to complete the SSMIS contract.

Audit Results. On October 7, 1994, the Air Force official directed the SMC Deputy Commander to initiate a detailed audit and analysis of the Aerojet equitable adjustment claim and to appoint an SMC staff officer not connected with the DMSP program to lead the CAT. The CAT consisted of 11 representatives from SMC, the Defense Contract Management Command, Aerospace Corporation, and the Defense Contract Audit Agency. The CAT was chaired by a deputy program manager for another satellite program.

CAT conclusions were briefed to the Air Force official on January 27, 1995. The CAT recommended that the Air Force initiate settlement claim negotiations with Aerojet. The CAT stated that participating in negotiations would restore a good faith environment with the contractor and doing so was likely a less costly option than litigation. The CAT conclusions represented the majority opinion of the team.

No documentation existed that the CAT chairman was involved in the decision of the SMC Commander to assign a new contracting officer responsible for settlement negotiations with Aerojet.

Allegation 5. The Air Force official was responsible for an improper deferral of Air Force and Defense Logistics Agency claims against Aerojet on the SSMIS contract, even though several Government reviewers recommended that the deferral not be approved.

Audit Results. No documentation existed that the Air Force official intervened in either the Air Force or the Defense Logistics Agency deferment decision-making process. Aerojet sought deferment of an Air Force contracting officer demand for payment of \$1.7 million in liquidated damages for Aerojet's failure to meet the initial February 1994 delivery of two SSMIS units. Aerojet also requested deferment of \$6.7 million associated with two administrative contracting officer demands for repayment of premature progress payments.

The Office of the Assistant Secretary of the Air Force (Financial Management and Comptroller) and the Comptroller of the Defense Logistics Agency made their final decisions on January 20, 1995, and December 12, 1994, to approve deferment requests of \$1.7 million and \$6.7 million, respectively. Adequate rationale existed to support both the Air Force and the Defense Logistics Agency deferment decisions. The contracting officer recommended that deferment of the \$1.7 million request be denied, and the DMSP systems program office director and the Air Force Materiel Command concurred with the procurement contracting officer recommendation. However, the recommendation was not accepted by the Office of the Assistant Secretary.

Allegation 6. The Air Force official told the SMC Commander that the Aerojet claim should be settled and ordered that the SMC contracting officer be removed from any claim settlement discussion.

Audit Results. On February 27, 1995, the Air Force official informed the SMC Commander that the CAT findings were consistent with those of the Red Team and requested that SMC pursue resolution of the Aerojet claim through negotiations with Aerojet. We believe that the request for SMC to pursue resolution of the claims was proper because Government consideration of the opportunities to arrive at a common settlement while the claims are in litigation is prudent. Claims may be settled at any time right up to the time of the decision of the board or court. No documentation existed that the contracting officer was removed by direct order of the Air Force official.

Allegation 7. Aerojet failed to deliver any SSMIS units (the first unit was due in 1993) and is now in contract default. Also, Aerojet provided no limitations of funds notice before its failure to deliver the SSMIS units.

Audit Results. Aerojet has not delivered the first SSMIS unit. The contract required delivery of the first SSMIS unit by August 31, 1993. Aerojet failed to meet initial delivery schedules on three separate occasions for the SSMIS contract. Each failure resulted in a contracting officer issuing a show cause notification. The Air Force unilaterally extended the first delivery to May 1, 1995. Aerojet stated that the Government should not attempt further schedule enforcement until a negotiated settlement is reached.

Aerojet did not provide timely limitation of funds notice on developmental work performed after the 1991 critical design review. In July 1991, the Air Force provided \$750,000 in cost reimbursable funding for post-critical design review work. In April 1994, Aerojet requested that the Air Force provide additional development and design funding of \$8.8 million. The Air Force denied the request and directed Aerojet to continue performance under the fixed-price production portion of the SSMIS contract.

Aerojet may be in contract default. Certain Air Force documentation indicates that both SMC program management and legal personnel consider Aerojet to be in default. In June 1995, to determine whether the SSMIS would be delivered and, if so, when, the Air Force initiated a review of the Aerojet production effort.

Allegation 8. The Air Force official has been involved in directing monies to be paid on many other disputes, claims, and contractor requests for additional contract funds.

Audit Results. Five to six Air Force "Red Teams" are formed each year to evaluate individual programs, many of which have equitable adjustment claims in litigation. Only a small percentage of equitable adjustment claims end in litigation. The Air Force Material Command's Office of Chief Trial Attorney estimates that on average 400 Air Force-related equitable adjustment litigations, valued at over \$1 billion, are currently scheduled for review by the Armed Services Board of Contract Appeals.

Government contracts are complex documents involving a maze of clauses, special conditions, detailed specifications, and performance standards. Disputes over contract requirements arise when disagreements cannot be resolved by mutual agreement. The result is submission of a claim and possibly litigation if agreement still cannot be reached. Section 6 of the Contract Disputes Act of 1978, as amended (United States Code, title 41, paragraphs 605[d] & [e]), authorizes Federal agencies to engage in alternate means of dispute resolution proceedings leading to negotiated settlement of claims.

Management Comments

We provided a draft of this report to management on September 15, 1995. Because this report contains no findings or recommendations, written comments were not required, and none were received. Therefore we are publishing this report in final form.

The courtesies extended to the audit staff are appreciated. If you have any questions on this audit, please contact Mr. Garold E. Stephenson, Audit Program Director, at (703) 604-9332 (DSN 664-9332) or Mr. Charles M. Hanshaw, Audit Project Manager, at (703) 604-9256 (DSN 664-9256). The distribution of this report is listed in Enclosure 2. The audit team members are listed inside the back cover.



Robert J. Lieberman
Assistant Inspector General
for Auditing

Enclosures

Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology, Washington, DC
Director, Defense Procurement, Washington, DC

Department of the Air Force

Assistant Secretary of the Air Force (Acquisition), Washington, DC
Assistant Secretary of the Air Force (Financial Management and Comptroller),
Washington, DC
Office of General Counsel, Washington, DC
Air Force Materiel Command, Wright-Patterson Air Force Base, OH
Space and Missile Systems Center, Los Angeles Air Force Base, CA

Defense Organizations

Defense Contract Audit Agency, Alexandria, VA
Defense Contract Audit Agency, Pomona Valley Branch Office, Western Region,
West Covina, CA
Defense Logistics Agency, Alexandria, VA
Defense Contract Management Command, Alexandria, VA
Defense Contract Management District-West, El Segundo, CA
Defense Contract Management Area Operations, Santa Ana, CA
Defense Contract Management Office, Aerojet-General Corporation,
Azusa, CA
Defense Contract Management Office, Ontario, CA

Non-Government Organization

Aerospace Corporation, El Segundo, CA

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House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal
Justice, Committee on Government Reform and Oversight
House Committee on National Security

Audit Team Members

This report was prepared by the Contract Management Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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